Project Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 09-Sep-2022 | Report No: PIDA34795

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Ukraine	P179875	Third Additional Financing for Public Expenditures for Administrative Capacity Endurance (PEACE) in Ukraine	P178946
Parent Project Name	**Region**	**Estimated Appraisal Date**	**Estimated Board Date**
Public Expenditures for Administrative Capacity Endurance (PEACE) in Ukraine	EUROPE AND CENTRAL ASIA	07-Sep-2022	29-Sep-2022
Practice Area (Lead)	**Financing Instrument**	**Borrower(s)**	**Implementing Agency**
Governance	Investment Project Financing	Ukraine	Ministry of Finance

Proposed Development Objective(s) Parent

To contribute to sustaining the government administrative and service delivery capacity to exercise core government functions at the national and regional levels

Components

Social Assistance and Pensions
Healthcare and First Responders
Support to government and school employees wage bill
Audit expenses

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	3,580.00
Total Financing	530.00
of which IBRD/IDA	530.00
Financing Gap	3,050.00

DETAILS

World Bank Group Financing

International Bank for Reconstruction and Development (IBRD)	530.00

Environmental and Social Risk Classification

Substantial

Other Decision (as needed)

B. Introduction and Context

Country Context

1. **Russia's invasion of Ukraine on February 24, 2022 has had devastating economic consequences.** According to official statistics Ukraine's gross domestic product (GDP) shrank by 19.3 percent (quarter-on-quarter seasonally adjusted) in Q1 2022, with a steeper decline expected in Q2. Assuming the war continues, a 45 percent GDP contraction is projected in 2022. Inflation increased to 21.5 percent (year on year) in June due to supply disruptions and increased production costs caused by extensive damage to production facilities, interruptions to logistics networks, and displacement of employees. Consumer prices are expected to increase further due to the supply side shocks and increased depreciation expectations of Ukraine's currency. With the war continuing, Ukraine is facing a number of macro-critical challenges: (i) high fiscal financing needs and inability to mobilize domestic revenues; (ii) increasing reliance on monetary financing; (iii) deteriorating asset quality of the financial sector; and (iv) a weak external position.

2. **Ukraine's public finances remain under severe pressure, with disbursement of external donor financing only partially covering the financing needs.** Monthly tax revenues have dropped by nearly half relative to pre-war levels, even as spending needs have sharply risen. For the year 2022, General government's revenues are expected to drop by 45 percent due to both: a sharp deceleration in economic activity and tax policy changes (when the war began, the government introduced tax holidays for some taxes, including import duties). From July 1, 2022, import duties were re-established at the pre-war level, which are expected to support fiscal revenues going forward. At the same time, given the prolonged war, fiscal revenues are expected to remain depressed for a considerable period even after the war ends. Non-military financing needs to maintain critical public and social services amounted to US$11 billion equivalent in Q2 and are estimated at US$15.4 billion in the second half of the year, including expenditure for gas purchases for the heating season. Moreover, starting from September the government may face an urgent repair and reconstruction need, estimated at additional US$3.4bn. The government is trying to reduce financing needs. In August, the government successfully completed its external liability management transaction related to a two-year freeze on payments on its Eurobonds (US$19.6 billion). This followed on the initiative to suspend debt service payments of major official bilateral creditors for Ukraine till the end of 2023 with the possibility to extend the suspension by one more year. Due to delays in international

financing during April-June, Ukraine had to rely on domestic sources to meet its urgent fiscal needs. The National Bank of Ukraine (NBU) has already monetized over US$8.5 billion in fiscal needs since the beginning of the war. If monetization of fiscal needs continues, inflationary pressures will continue to build and will become increasingly difficult to bring under control going forward.

Sectoral and Institutional Context

3. **The war resulted in immediate balance of payments pressures through several channels.** First, due to the blockade at Black Sea ports, Ukraine almost fully lost its ability to export grain and other agricultural commodities. In August, the United Nations brokered a grain export corridor, which was established to allow resumption of exports of agricultural commodities through the Black Sea ports. However, war export of goods would remain depressed, declining almost by half (in both month-over-month and year-over-year terms). This may lead to significant broadening of the current account deficit in the second half of 2022, as imports have already started to recover in May-June. Second, huge outflows of refugees have created capital account pressures due to withdrawal of FX funds from their Ukrainian accounts to finance their spending abroad. In the absence of balance of payments support, these pressures will continue to build. In response to growing pressures on FX, on July 21, the National Bank of Ukraine changed the official, fixed exchange rate to UAH36.6/US$1, a 25 percent increase from the UAH29.25/US$1 maintained from the beginning of the war. The NBU had been actively intervening to defend the exchange rate, using approximately US$12 billion since the beginning of the war. In recent months, this has led to an accelerating reduction in international reserves, to US$22.4 billion in July, down from US$29 billion prior to the war. Together with the increase in the policy interest rate to 25 percent, the NBU expects this measure to reduce demand for foreign exchange.

4. **The Ukrainian banking system entered the war in a relatively good condition.** The war is expected to affect banks' asset quality and solvency. The electronic payment system infrastructure has remained fully operational since the start of the war and about 87 percent of bank branches remain operational as of mid-June. Liquidity remains at sufficient levels, given a relatively stable deposit base and refinancing support from the NBU. Recent amendments introduced a blanket guarantee for retail deposits and brought Oschadbank – a state-owned bank - under the deposit guarantee system. At the same time, loss of assets, collateral, and revenues will severely affect banks' profitability and solvency. During March-July, the banking sector already accounted for US$1.9 billion (UAH 68 billion) for expected war-related credit losses. While some banks will be able to recover capital themselves through their future profits, others will likely need to be recapitalized by their shareholders.

5. **In response to the Government of Ukraine (GoU) request on September 7, 2022, the proposed Third AF provides further support to core government functions at the national and regional levels.** The PEACE project provides funding to cover the wage bill of non-security sector government employees, pensions, social payments, and education, emergency and healthcare services that are essential to ensure continuity of core government functions and mitigate the social and economic impact of the war. The Third AF provides additional funding to cover US$530 million of these expenditures incurred by the government August-October

6. **Government spending on core public services and social payments for the duration of the project is vast** and remains considerably larger than the amount of financing available (see Table 1). The expenditure estimates presented in the Table 1 are USD equivalent and are based on historical data and government estimates. The expenditures will fluctuate and could be lower should devaluation of local currency occur. This Third AF will scale

up this support by increasing the amount of eligible expenditures reimbursement to up to 100 percent of eligible expenditures under Components 1, 2 and 3 of the Project. The development partners are ramping up planned support to Ukraine with the EU announcement of EUR 5 billion[1] in budget support and US request of USD 4.5 billion in economic support,[2] but the needs continue to persist over the medium term.

7. **From the beginning of the war, the Government sustained its core services and social payments.** Including with support from the PEACE project, in July 2022 7.98 million pensioners have received their pensions our of estimated 8 million with pensions accrued. Most of the remaining 200 thousand pensioners are likely to receive it later with delays related to the ability of the postal service to deliver pension payments in war affected areas. Over 95 percent of social assistance beneficiaries also received their payments on time in June and July of 2022. Education services continue to be delivered with the MoES reporting on August 31 that, out of 12,900 schools starting the new academic year on September 1, 42 percent would operate remotely, 30 percent would operate in a blended mode and 28 percent would provide in-person classes. Strong regional differences are expected. For instance, only 12 percent of schools in Odeska oblast will provide in-person classes on September 1, while this figure goes up to 55 percent in Lvivska oblast, and goes down to fully remote modality in Donetska or Kharkivska oblasts.

8. **This Third AF provides emergency support to Ukraine during the war - as part of the World Bank Group (WBG) Response to the Global Impacts of the War in Ukraine – A Proposed Roadmap - and supports the priority themes under the WBG Strategy for Fragility, Conflict, and Violence 2020-2025 (Report No. 146551)**. The Third AF, consistent with the parent project, is a core element of the initial fast-track response under the strategic framework for the WBG on Global Impacts of the War in Ukraine. It supports both short-medium and long-term considerations outlined in the Proposed Roadmap presented by Bank management to the Bank's board on April 12, 2022, the first dimension of which is increased support to Ukraine, including through financing sizeable non-military expenditure needs.

C. Proposed Development Objective(s)

Original PDO

To contribute to sustaining the government administrative and service delivery capacity to exercise core government functions at the national and regional levels.

Current PDO

No changes to the PDO.

Key Results

9. **The results framework of the project will not change.** The parent project already envisaged that with partial reimbursement of the wage bill, the Government would be able to pay all salaries of employees on the payroll in school and government ministries, department, and agencies at the central and subnational levels. Given the continuation of the war, which continues to put pressure on the government fiscal situation, additional

[1] https://ec.europa.eu/commission/presscorner/detail/en/ip_22_5373

[2] https://thehill.com/homenews/administration/3625876-white-house-asks-congress-for-13-7b-in-ukraine-related-funding/

support will ensure salaries of those employees continue being paid. Consistent with the three-month extension, the end targets of the result indicators will be extended to June 30, 2023.

10. **The Third AF will use the design of the parent project, relying on country systems and strengthened social, environmental, and fiduciary arrangements when needed and practical.** As a result, the Third AF will support financing eligible government expenses based on government delivery systems. The Third AF will be implemented based on the Project Operational Manual of the parent project, which will be updated within fifteen days of effectiveness of the AF loan agreement as appropriate to reflect the additional financing.

D. Project Description

11. **The PDO will remain the same as originally stated: to contribute to sustaining the government administrative and service delivery capacity to exercise core government functions at the national and regional levels.** The Third AF will reimburse eligible expenditures from any of the three components of the project. The expenditure types under these components are spelled out in Table 2. The achievement of the PDO supports the Ministry of Finance's (MoF) objective of stable implementation of the State budget policy.

12. **Government spending on core public services for the duration of the PEACE Project is vast and remains considerably larger than the amount of financing available.** The parent project was going to provide funding to partially cover the wages of a subset of public sector workers – government and school employees- from March to November 2022 and had identified additional expenditures of US$550 million. The first AF scaled up funding up to 100 percent of the government and school employees wage bill in March to July 2022, covering these expenditures. At the same time, given the deteriorating fiscal situation it was noted that it would be important to continue funding the wage bill after July 2022, justifying additional spending of around US$550 million until November 2022. Given the difficult fiscal situation and potential future contributions of development partners to the MDTF, the Second AF identified US$1.65 billion of eligible expenditures as financing gap. Third AF covers US$530 million of these expenditures following the Second AF. The proposed extension of the project by three months would add around US$3 billion of new uncovered expenditures, bringing financing gap to be covered through future donor contributions to US$4.7 billion. The extension is justified based on the significant financing needs that would likely persist into the 2023 and the need to preserve the core government capacity and the provision of essential services and social payments to minimize human capital losses and facilitate reconstruction. Third AF creates a space to bring in new funding from development partners to support continuity of government core functions until June 2023.

Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Assessment of Environmental and Social Risks and Impacts

13. **The activities supported by the Project are not expected to have any direct adverse social risks or impacts, but they take place within a highly volatile context beyond the immediate control of the implementing agency.** The proposed Third AF will continue to fund expenditures identified in the parent project and the Second AF.

14. **The scope of the project results in substantial social risks arising from potential safety and health incidents associated with exposure to the war and aerial bombardment during delivery of services.** The original project provided funding to the wage bill of non-security sector government employees and school employees who are integral for ensuring continuity of core government services (mainly public administration and education services) and preventing erosion of learning outcomes. The Second AF expanded this support to cover pensions, social payments and health and emergency services that are essential to mitigate the social and economic impact of the war. The social risk is substantial given the potential for community and worker health and safety incidents during the delivery of the social services supported by the Third AF and associated risks and impacts. Some services will require participants to attend in person activities and would require essential workers to staff their places of employment or conduct outreach activities potentially increasing their risk of exposure to attack, especially in eastern parts of the country. This contextual risk also increases the likelihood that vulnerable groups and individuals who may be eligible to receive such services do not seek them out for fear of exposure to war fighting and bombing. These are highly contextual and beyond the immediate control of the project and not caused by the activities supported by the bank financing. Preventative measures for the Third AF activities under emergency conditions are already described in the project's ESCP and POM. These include principles for information disclosure and consultation, and GRM. The SEP for the project was revised during the Second AF to define principles for information disclosure and opportunity for feedback and access to redress for complaints and concerns for newly introduced Second AF supported activities.

15. **Data collection and processing.** Personal data are likely to be collected and processed in connection with Project activities, particularly in the case of social benefits payments. This may include the processing of sensitive data (including biometrics), which are collected and managed by the MoSP under their existing social assistance programs to support the identification (to determine uniqueness) and authentication (determining that the person eligible to receive the cash transfer is in fact the person they say they are). Ukraine currently has a data protection law of general application (Law No. 2297 VI 'On Personal Data Protection' as of June 1, 2010) that essentially meets international standards, albeit is in the process of being updated. Since 2014, the Ukrainian Parliament's Commissioner for Human Rights (Ombudsman) is the state authority in charge of overseeing compliance with the data protection law.

16. **In order to guard against abuse of this data, Project activities are implemented in accordance with the applicable national legal framework and good international practices for dealing with such data in such circumstances**. Such measures include complying with use limitations (data are only used for legitimate and related purposes to the disbursement of cash transfers), data minimization principles (only collecting and processing the data that is necessary for the legitimate purpose), limits on data retention (retaining the data only for as long as they are necessary), where practicable informing individual data subjects of how their data is used and processed, and allowing data subjects the opportunity to correct information about them and seek redress for abuse of these provisions, etc. Additional technical and organizational measures should be taken to ensure the protection of personal data against unlawful processing (loss, unlawful or accidental elimination) and

unauthorized access, including by third parties.

17. **The Third AF will not support physical works or envisage any other kind of activities that may cause direct or indirect environmental impacts**. The environmental rating is moderate given potential for community and worker health and safety incidents during the delivery of the social services supported by the Third AF and associated risks and impact.

E. Implementation

Institutional and Implementation Arrangements

18. **The governance and institutional arrangements of the PEACE project are designed to fit the current circumstances by using government processes where possible and ensuring the least additional administrative burden on the Government**. The first verification reports for March-May 2022 and for June 2022 were submitted by the MoF under the parent project and the first AF and were found satisfactory by the Bank. The Third AF will keep the project's arrangements, relying on the existing country system procedures which were deemed as satisfactory before the crisis and have continued to function during wartime.

19. **The Ministry of Finance of Ukraine remains the Implementing Agency of the project.** The appointed Project Coordinator (Deputy Minister) oversees project implementation, monitors progress, and ensures prompt delivery and reporting on project indicators. The Project Coordinator also acts as a focal point for communication with the World Bank team on project-related issues.

20. **The Project Operational Manual (POM) prepared under the Parent Project and updated under the Second AF will be used for the Third AF**. The POM reflects institutional arrangements and verification mechanisms for all types of eligible expenditures. The POM lays out the project's overall operating, fiduciary, verification protocols, decision-making procedures, eligibility criteria, and results monitoring arrangements in line with applicable World Bank policies. The POM will be updated within 15 days after the effectiveness of the Third AF to reflect minor changes related to the increased project amount.

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